



STATE BOARD OF EQUALIZATION STAFF LEGISLATIVE BILL ANALYSIS

Date Amended:	04/12/04	Bill No:	AB 2472
Tax:	Sales and Use Insurance Income	Author:	Wolk, et al
Board Position:	Oppose	Related Bills:	SB 1424 (Burton)

BILL SUMMARY

This bill would create the California Tax Court to replace the Board of Equalization (Board) as the body to hear and determine appeals on sales and use tax, specified insurance tax, and personal income and corporation tax matters.

Summary of Amendments

The amendments to the bill since the previous analysis, among other things, set forth provisions for optional hearings for cases falling below specified amounts. In addition, the amendments specify that the Evidence Code shall apply to all hearings before the proposed tax court.

ANALYSIS

Current Law

Under existing law, the Board administers, among other things, the following tax and fee programs: sales and use tax, Bradley-Burns uniform local sales and use tax, transactions and use tax, alcoholic beverage tax, cigarette and tobacco products tax, motor vehicle fuel tax, diesel fuel tax, interstate user tax, emergency telephone users surcharge, energy resources surcharge, insurance tax, integrated waste management fee, natural gas surcharge, childhood lead poisoning prevention fee, oil spill response and prevention fee, underground storage tank maintenance fee, use fuel tax, marine invasive species fee, hazardous substances tax, California tire fee, occupational lead poisoning prevention fee, timber yield tax and private railroad car tax. The Board also assesses the property of public utilities and common carriers, and provides certain administrative and oversight functions with respect to the local property tax.

The Board comprises four elected members, one from each equalization district, and the State Controller. The Board itself is responsible for setting the values for the Board roll (utilities and common carriers). It also hears appeals relating to all of the taxes and fees it administers, as well as the taxes administered by the Franchise Tax Board (FTB).

Proposed Law

This bill would amend specified provisions in the Sales and Use Tax Law, the Tax on Insurers, the Personal Income Tax Law and the Corporations Tax Law to provide that all petitions for redeterminations and/or appeals filed pursuant to those laws be filed with the California Tax Court, which this bill would create, within 90 days after service upon the person of notice thereof.

The bill would create the California Tax Court (Court) and would provide, among other things, the following:

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- The Court would consist of 5 judges appointed by the Governor and confirmed by the Senate, with term limits of 12 years, except as specified initially.
- Each candidate for a judge shall be a citizen of this country, a resident of California, and a licensed attorney that has engaged in the active practice of law with a primary focus on taxation for at least 5 of the 10 years preceding his or her appointment.
- The Court's principal office would be in Sacramento, but may hold hearings at any place within the state.
- The provisions of the Evidence Code shall apply to all evidentiary hearings before the Court.
- The decision of the judge holding the hearing is not subject to approval by the remaining members of the Court, however, the Chief Judge or the majority of the Court's judges, may determine whether such a decision should be decided by the entire Court.
- The taxpayer, or the Board, FTB, or the Insurance Commissioner may file an appeal with the Court within 90 days of the decision.
- The decision of the Court becomes final 90 days following its issuance of its decision.
- The Court's final action shall be considered res judicata with respect to any original action on a claim for refund filed in a state superior court.
- An optional hearing process whereby the taxpayer, with the concurrence of the Court, may elect to have a petition heard for which the total disputed amount is not in excess of specified thresholds. Any decision under this process may not be reviewed in any other court and may not be cited as precedent.

In General

In its December 2003 final report, the California Commission on Tax Policy in the New Economy¹ recommended that California establish a state administrative body to operate like the U.S. tax court. As an example, the Commission recommended an administrative body consisting of five administrative law judges, appointed by the Governor and confirmed by the Board or the Legislature, and that the administrative body would be formed under the legislative power, rather than a court with stature equivalent to the Superior Court. The recommendation further suggests that the administrative tax body consider *all* tax disputes, including personal income tax, corporate income tax, sales and use tax, property taxes, payroll taxes, and excise taxes.

On a separate note, Governor Schwarzenegger, on February 10, 2004, signed Executive Order S-5-04 creating the California Performance Review (CPR) to conduct a focused examination of California state government. Based on this examination and assessment, the CPR will formulate and recommend practical changes to government agencies, programs and operations to reduce total costs of government operations, increase productivity, improve services, and make government more responsive and accountable to the public.

¹ This commission was created through the enactment of SB 1933 (Ch. 619, Stats. 2000), the purpose of which was to "create an open, public, fair and balanced participatory process for the development of a long-term strategy for revising state and local tax structure for California that eliminates needless complexity and nurtures and expands the state's global leadership in key emerging industries and for businesses that are repositioning to take advantage of the new economy."

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The CPR has four major components as outlined in the Governor's Budget Summary 2004-05: (1) Executive Branch Reorganization; (2) Program Performance Assessment and Budgeting; (3) Improved Services and Productivity; and (4) Acquisition Reform. Teams of approximately 150 state workers, on loan from different agencies and departments, will examine these areas of state government. A California Performance Review Commission will also be created, which may consist of legislators, representatives from local government, other Constitutional officers, and other interested parties. The purpose of the Commission is to provide counsel, advice, and conduct public hearings to get input from the general public on the current performance of government operations and ways to improve that performance.

The CPR is to make its final recommendations to the Governor not later than June 30, 2004.

Legislative History of the Concept of a State Tax Court

The following bills have been introduced over the years that proposed to create a state tax court or similar judicial body to hear tax appeals:

- **AB 2794 (Bowen, et al) of the 1995-96 Legislative Session**, would have abolished the FTB and, except as provided by the Constitution, the administrative authority of the Board, and would have provided for the transfer of their respective powers and duties to the Department of Revenue, which this bill would have created. This bill would have also created a Board of Tax Appeals consisting of seven members appointed by the Governor to serve as an appellate body to hear all tax appeals. This bill failed passage in the Assembly Revenue and Taxation Committee.
- **SB 1727/SCA 29 (Kopp) of the 1995-96 Session**, would have, among other things, done the following: (1) abolished the FTB and the Board and transferred their powers and duties to the California State Tax Authority, which this bill would create; and (2) created a Board of Tax Appeals consisting of seven members appointed by the Governor to serve as an appellate body to hear all tax appeals. Both bills were held in the Senate Appropriations Committee.
- **SB 87/SCA 5 (Kopp) of the 1993-94 Legislative Session**, would have, among other things, done the following: (1) abolished the FTB and the Board and transferred their powers and duties to the Department of Revenue, which the bill would create; and (2) create a Board of Tax Appeals. SB 87 failed on the Senate floor. SCA 5 was placed on the Senate inactive file.
- **SB 23 (Kopp) of the 1991-92 Legislative Session**, would have, among other things, done the following: (1) abolished the FTB and the Board and transferred their powers and duties to the Department of Revenue, which the bill would create; and (2) create a Board of Tax Appeals. This bill failed to move out of the Senate.
- **SB 1395 (Kopp, Ayala, et al.) of the 1989-90 Legislative Session**, would have, among other things, done the following: (1) abolished the FTB and the Board and transferred their powers and duties to the Department of Revenue, which the bill would create; and (2) create a Board of Tax Appeals. This bill failed passage in the Senate Appropriations Committee.

- **SB 1685 (Kopp) of the 1991-92 Legislative Session**, would have, among other things, done the following: (1) abolished the FTB and the Board and transferred their powers and duties to the Department of Revenue, which the bill would create; and (2) create a Board of Tax Appeals. SB 1685 was sent to interim study. The Assembly Revenue and Taxation Committee held an oversight hearing on February 24, 1992, which reviewed specific issues related to consolidating the FTB and the Board into a Department of Revenue. The issues discussed included: administration, audit, collections, return processing, legal divisions/appeals process, facilities, and data processing. It was noted in the hearing that the state's budget crisis made consolidation less attractive at the time due to its costs and complexities.

COMMENTS

1. **Sponsor and purpose.** This measure is sponsored by its author. According to the author's office, it is intended to, in part, carry out the recommendation of the California Commission on the New Economy. The author's office believes that by establishing an independent tax court, taxpayers would receive fair and equal treatment, and, that tax disputes would be resolved consistently as those resolved at the federal level.
2. **The April 12 amendments** incorporate provisions that would provide an optional hearing process for cases falling below specified thresholds. In addition, the bill would specify that the Evidence Code shall apply to all evidentiary hearings before the proposed Court.
3. **A majority of the Board Members and Board staff have the following concerns with this bill:**
 - California already has a tax court that is accountable to the voters – the Board of Equalization (BOE). The BOE has been regularly commended as a model agency.
 - A new California Tax Court would be costly at a time when we barely have enough money to fund existing Judicial Branch courts. A 5-judge court that holds hearings throughout the state could cost the state in excess of \$6 million per year (see cost estimate on page 6). Since the Board Members would continue to hold hearings on sales and use and insurance claims for refund as well as appeals arising under the numerous other tax and fee programs the Board administers, the savings attributable to the decrease in Board hearing workload would be minimal in comparison to the significant costs of a tax court. Also, this minimal savings would be further offset by costs associated with Board staff time associated with coordinating cases with the proposed tax court.

In addition, to the extent the bill would allow a taxpayer to defer payment of the disputed liability until the taxpayer has exhausted his or her judicial remedies, the State would lose the use of the funds it currently collects.

- A tax court following the same rules of practice as the United States tax court could intimidate taxpayers. Although the bill would allow a taxpayer to represent himself or herself before the proposed tax court, due to the increased complexity that would be associated with the proposed the tax court, taxpayers may feel the

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need to hire highly specialized attorneys to navigate the rules of the court, especially considering the fact that relatively few attorneys or other practitioners that the tax court may allow are familiar with the United States Tax Court's rules of practice. Since the proposed tax court would be less accessible to taxpayers it would not provide more fairness or equitable resolutions for disputed tax cases.

- The bill forces small businesses and individual taxpayers to endure complicated procedures and lengthy hearings before non-elected tax court “judges” (in reality, hearing officers). AB 2472 is modeled on the U.S. Tax Court, whose procedures are 200 pages long. In contrast, individual taxpayers and small businesses can get a quick hearing with informal procedures (32 pages) before elected BOE members who go on the ballot every four years.
 - The bill provides that tax court “judges” can serve without election for 12 years. In contrast, BOE members and the Controller are up for election every 4 years, and are limited by Proposition 140 to two four-year terms. AB 2472 takes the BOE member selection process away from the voters, and allows the Governor and the Senate to give 12-year tax court terms to political cronies.
 - The bill takes away both the taxpayer's automatic right to a hearing at the BOE, and the right to appeal an unfavorable BOE determination to Superior Court. Instead, the taxpayer must go to the new tax court, and if he or she loses, has only a discretionary appeal by writ to the Court of Appeal. Under existing law, the taxpayer can go to the BOE, then to Superior Court, and has an automatic appeal to the Court of Appeal.
 - Because the tax court is really an administrative body, it cannot resolve constitutional questions (see California Constitution, Article III, Section 3.5). Under existing law, the Superior Court can hear constitutional questions, but AB 2472 takes away the taxpayer's automatic right to appeal an unfavorable BOE decision to Superior Court.
 - The bill gives the Franchise Tax Board staff new authority to appeal an unfavorable tax court decision to the Court of Appeal.
 - The bill violates Article VI, Section 10 of the California Constitution, which gives the Superior Courts original jurisdiction in all cases, including appeals of BOE and FTB tax decisions.
- 4. The Board's existing administrative process is working well.** The vast majority of petitions or appeals are resolved administratively. Of approximately 2,400 sales and use, insurance, and income tax appeals filed each year, an average of only about 17 cases are actually filed in the superior courts.
- 5. Is January 1, 2005 enough time to establish the tax court?** The provisions of the bill would become operative January 1, 2005, and as of that date, the bill would provide that petitions and appeals be filed with the California Tax Court. However, this would provide virtually no lead time in which to have judges selected and confirmed by the Senate. Where would the petitions/appeals be filed before the tax court is established? And, since interest on any unpaid liabilities continues to accrue after a petition or appeal is filed, taxpayers may be unfairly penalized for the interest

accumulating until the time the California Tax Court is established and in position to hold hearings.

6. **Board would still be empowered to consider claims for refund.** While this measure provides a judicial remedy for taxpayers filing petitions for redeterminations and appeals, the bill is silent with respect to claims for refund. Absent specific language, it appears the Board would continue to have jurisdiction over any claims for refund filed both before and after the determination is made by the proposed California Tax Court.
7. **Related legislation.** Provisions similar to this bill are also contained in SB 1424 (Burton).

FISCAL ESTIMATE

Enactment of this measure could result in significant costs as follows:

- Past legislative proposals have included creating a separate tax court that would hold hearings throughout the state. Each of these proposals would have required the appointment of judges who are certified tax specialists. When these proposals were being considered in the early 1990's, the Judicial Council estimated that the costs of operating such a tax court could range from \$6.5 to \$7.5 million for a five-judge court. The present-day costs of operating such tax courts would be considerably higher. As an order of perspective, the current State Bar Court budget has annual costs of over \$8 million to operate a five-judge court, plus a three-judge appellate hearing court, and 34 employees.
- Since the bill would only create a new venue for sales and use, insurance, and income and franchise tax cases, any administrative costs savings to the Board would be insignificant. This is so, because the Board would continue to consider claims for refund for sales and use and insurance tax programs, as well as continue to hold hearings on the many other tax and fee programs the Board administers. In addition, any savings would be offset by the administrative costs attributable to Board staff time necessary to coordinate cases with the proposed Tax Court.
- Currently, approximately \$50 million in tax revenues have been paid to the State by taxpayers who are awaiting judicial review. Payment of the tax is required under current law prior to filing an action in superior court. To the extent this bill would allow taxpayers to defer payment until such time that all appeals have been exhausted, the State's access to such revenues would be significantly delayed. In addition, this would also create an added incentive for taxpayers to continue appealing their cases, thereby further delaying the State's use of the funds.

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